

where D owns the software businesses related only to industries 3, 4, 5, and 6. Thereafter, D concludes that the intellectual property licenses central to the software business related to industries 1 and 2 are not transferable and that a separation of the software business related to industry 3 from the software business related to industry 2 is not desirable. One month after D begins negotiating with X, D contributes the software businesses related to industries 4, 5, and 6 to C, and distributes the stock of C pro rata to its shareholders. In addition, X sells its hardware businesses for cash. After the distribution, C and X negotiate for X's acquisition of the C stock from the C shareholders in exchange for X stock, and X acquires the stock of C.

(ii) Although D and C are different corporations, C does not own the custom software business related to industry 3, and X sold its hardware business prior to the acquisition of C, because X's acquisition of C involves a combination of a significant portion of the same business operations as the combination that would have been effected by the acquisition of D that was the subject of negotiations between D and X, X's acquisition of C is the same as or similar to X's potential acquisition of D that was the subject of earlier negotiations.

(k) *Effective dates.* This section applies to distributions occurring after April 26, 2002. Taxpayers, however, may apply these regulations in whole, but not in part, to a distribution occurring after April 16, 1997, and on or before April 26, 2002. For distributions occurring after August 3, 2001, and on or before April 26, 2002 with respect to which a taxpayer chooses not to apply these regulations, see § 1.355-7T as in effect prior to April 26, 2002 (see 26 CFR part 1 revised April 1, 2002).

[T.D. 8988, 67 FR 20632, Apr. 26, 2002; 67 FR 38200, June 3, 2002]

§ 1.356-1 Receipt of additional consideration in connection with an exchange.

(a) If in any exchange to which the provisions of section 354 or section 355 would apply except for the fact that there is received by the shareholders or the security holders other property (in addition to property permitted to be received without recognition of gain by such sections) or money, then—

(1) The gain, if any, to the taxpayer shall be recognized in an amount not in excess of the sum of the money and the

fair market value of the other property, but,

(2) The loss, if any, to the taxpayer from the exchange or distribution shall not be recognized to any extent.

(b) If the distribution of such other property or money by or on behalf of a corporation has the effect of the distribution of a dividend, then there shall be chargeable to each distributee (either an individual or a corporation)—

(1) As a dividend, such an amount of the gain recognized as is not in excess of the distributee's ratable share of the undistributed earnings and profits of the corporation accumulated after February 28, 1913, and

(2) As a gain from the exchange of property, the remainder of the gain so recognized.

(c) This section may be illustrated by the following examples:

Example (1). In an exchange to which the provisions of section 356 apply and to which section 354 would apply but for the receipt of property not permitted to be received without the recognition of gain or loss, A (either an individual or a corporation), received the following in exchange for a share of stock having an adjusted basis to him of \$85:

One share of stock worth	\$100
Cash	25
Other property (basis \$25) fair market value	50
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Total fair market value of consideration received ..	175
Adjusted basis of stock surrendered in exchange	85
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Total gain	90
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Gain to be recognized, limited to cash and other property received	75
A's pro rata share of earnings and profits accumulated after February 28, 1913 (taxable dividend)	30
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Remainder to be treated as a gain from the exchange of property	45

Example (2). If, in *Example (1)*, A's stock had an adjusted basis to him of \$200, he would have realized a loss of \$25 on the exchange, which loss would not be recognized.

(d) Section 301(b)(1)(B) and section 301(d)(2) do not apply to a distribution of "other property" to a corporate shareholder if such distribution is within the provisions of section 356.

(e) See paragraph (1) of § 1.301-1 for certain transactions which are not within the scope of section 356.